

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

BOBBY WRIGHTON,
Debtor.

Case No.-04- 55447-MM
Chapter 13

BOBBY WRIGHTON,
Plaintiff,
vs.

Adversary No. 05-5439

STATE OF CALIFORNIA DEPARTMENT
OF INDUSTRIAL RELATIONS, et al.
Defendant.

OPINION

INTRODUCTION

Shortly before Bobby Wrighton filed his chapter 13 petition, the State of California Department of Industrial Relations (DIR) recorded a lien against Wrighton's property in Monterey County, California to secure payment of the state's potential liability on a workers' compensation claim pending against Wrighton. In this adversary proceeding, Wrighton alleges that the DIR lien should be avoided under Bankruptcy Code § 547(b) because it was recorded during the statutory preference period. The

1 DIR moves to dismiss Wrighton's complaint urging that Wrighton lacks standing to avoid the lien and
2 that the lien, being a statutory lien, is not avoidable.

3
4 **BACKGROUND**

5 **I. The Statutory Framework Relating to Workers' Compensation Benefits and Uninsured Employers.**

6 In California, every employer has a legal duty to ensure that workers' compensation benefits are
7 available for their employees. CAL. CONST. Art. XI, § 4. To satisfy this obligation, employers must
8 either carry workers' compensation insurance or be lawfully self-insured. CAL. LABOR CODE § 3700.
9 An employer that fails to secure payment of compensation in one of these two ways is illegally
10 uninsured.

11 An employee who is injured while working for an illegally uninsured employer may pursue two
12 separate avenues of recovery: 1) a state court suit for damages, *id.* at § 3706; or, 2) an administrative
13 application for compensation that is prosecuted before the state Workers' Compensation Appeal Board,
14 *id.* at § 3715. When an injured worker files an administrative claim with the WCAB, the board must
15 make a determination awarding compensation as if the employer was properly insured. *Id.* If the
16 employer fails to pay the award or to post the appropriate bond, the state becomes obligated to satisfy
17 the award. *Id.* at § 3716.

18 The director of the DIR uses the Uninsured Employers Benefit Trust Fund (UEF) to pay
19 workers' compensation awards. *Id.* Awards paid out of the UEF constitute a claim for liquidated
20 damages against the uninsured employer, which the director of the DIR can pursue in state court. *Id.*
21 at § 3717(a). Additionally, the Labor Code independently authorizes the DIR to record liens against an
22 illegally uninsured employer's property. *Id.* at § 3720(a). This section provides that

23
24 When the appeals board or the director determines under section 3715 or 3716 that an
25 employer has not secured the payment of compensation as required by this division or
26 when the director has determined that the employer is *prima facie* illegally uninsured,
27 the director may file for record in the office of the county recorder in the counties where
28 the employer's property is possibly located, a certificate of lien showing the date that the
employer was determined to be illegally uninsured or the date that the director has
determined that the employer was *prima facie* illegally uninsured. . . . Upon the
recording, the certificate shall constitute a valid lien in favor of the director, and shall
have the same force, effect and priority as a judgment lien and shall continue for 10

1 years from the time of the recording of the certificate unless sooner released or otherwise
2 discharged.

3 CAL. LABOR CODE § 3720(a).

4 To record a lien before the WCAB has entered a final award, the director of the DIR need only find that
5 an employer is prima facie illegally uninsured. A minimal level of evidence is enough. For example,
6 the nonexistence of a record of insurance with the Workers' Compensation Insurance Rating Bureau is
7 sufficient. *Id.* at §3715. Once the director makes a prima facie determination, the director may perfect
8 a certificate of lien by recording it in any county where the employer may possibly have property. *Id.*
9 at § 3720(a). Liens filed under § 3720 may be foreclosed independently of any right of action on a claim
10 for liquidated damages. *Id.* at § 3720(d).

11 Previously, the ninth circuit recognized, in a case arising under Arizona law, that an employer's
12 obligation to reimburse that state's UEF for paying a workers' compensation award was a non-
13 dischargeable excise tax. *Industrial Comm'n. of Ariz. v. Camilli (In re Camilli)*, 94 F.3d 1330 (9th Cir.
14 1996). In 2004, however, the circuit court distinguished the California workers' compensation statutory
15 scheme from the Arizona statute at issue in *Camilli* and held that under California law, an employer's
16 debt to the UEF does not qualify as a non-dischargeable excise tax. *George v. Uninsured Employers*
17 *Fund (In re George)*, 361 F.3d 1157 (9th Cir. 2004). The court explained that generally, the term "excise
18 tax" refers to taxes on the sale of a specific commodity that was measured by the value or the quantity
19 of the commodity sold. *Id.* at 1163. This sense is preserved in the bankruptcy because the Code limits
20 non-dischargeability to an excise tax on a *transaction* occurring during the three years immediately
21 preceding the petition date. 11 U.S.C. § 507(a)(8) and § 523(a)(1)(A). Noting that UEF claims for
22 reimbursement arise out of an employer's *failure* to engage in the transaction of purchasing workers'
23 compensation insurance, the court reasoned that the UEF claim could not be an excise tax due to the
24 absence of the statutorily required transaction. *Id.*

25 In *George*, the sole issue on appeal was whether the underlying debt to the UEF qualified as an
26 excise tax. The DIR did not raise and the ninth circuit did not consider the alternative issue before this
27 court: assuming that a debt to the UEF is not an excise tax and is therefore dischargeable, is a lien filed
28 pursuant to § 3720 of the Labor Code to secure payment of a debt to the UEF an unavoidable statutory

1 lien that rides through the bankruptcy. This issue, which has not been addressed in this circuit, is
2 significant because the Bankruptcy Code does not preclude post-discharge enforcement of liens that
3 were not avoided.

4
5 **II. The Administrative Proceeding Against Wrighton, the DIR Lien, and Wrighton's
6 Bankruptcy Petition.**

7 In 2002, Juan Fuentes was injured while working for Wrighton and filed a workers'
8 compensation claim against him. While Fuentes' administrative proceeding was pending, the director
9 of the DIR, pursuant to § 3720, caused a certificate of lien to be filed against Wrighton's property
10 located in Monterey County, California. The lien was recorded on August 19, 2004 in favor of the State
11 of California, Director of Industrial Relations.

12 On August 31, 2004, Wrighton filed a petition for relief under chapter 13 of the Bankruptcy
13 Code. The petition automatically stayed further proceedings on Fuentes' claim before the WCAB.
14 Although Fuentes' claim had not been finally determined, nor had been paid by the UEF, the DIR filed
15 a proof of claim in Wrighton's bankruptcy case for \$138,835, the estimated total of Fuentes'
16 administrative claim as of the petition date. Several months later, Wrighton commenced this adversary
17 proceeding to avoid the DIR lien recorded against his property. While Fuentes has been granted relief
18 from the automatic stay to liquidate his workers' compensation claim before the WCAB, at the time of
19 the hearing on this motion to dismiss, the WCAB had not yet determined whether any compensation is
20 due to Fuentes.

21
22 **LEGAL DISCUSSION**

23 **I. The Debtor Has Standing To Pursue The Avoidance Action Alleged In The Adversary
24 Complaint.**

25 Although no circuit court has directly addressed the issue, the bankruptcy appellate panel for the
26 ninth circuit has concluded that chapter 13 debtors have statutory standing to exercise trustee avoiding
27 powers for the benefit of the estate. *Houston v. Eiler (In re Cohen)*, 305 B.R. 886, 894-99 (9th Cir.
28 B.A.P. 2004). In reaching this conclusion, the appellate panel noted a lower court split on the issue
depending on whether a particular court followed a narrow or broad approach to construing statutes.

1 Under the narrow approach, some courts have concluded that the avoiding powers under §§ 544-549
2 limit standing exclusively to the trustee because the statutory provisions only refer to the trustee. *Id.*
3 at 893. The courts favoring standing, by contrast, focus on the economic realities of chapter 13, the
4 limited role of the chapter 13 trustee and how Congress intended to make chapter 13 function. *Id.* at
5 894. Rather than choose sides, the appellate panel in *Cohen* bridged the gap by applying the Supreme
6 Court’s “holistic” approach to construing the Bankruptcy Code. *Id.* at 895, citing, *United Sav. Ass’n*
7 *of Texas v. Timbers of Inwood Forest Associates., Ltd.*, 484 U.S. 365, 371, 108 S. Ct. 626, 630 (1988).
8 Under this approach, the court in *Cohen* looked beyond the individual provisions allocating powers
9 among debtors and trustees to consider the substance of the chapter 13 statutory scheme as a whole.
10 Using that holistic approach, the appellate panel persuasively explained why chapter 13 debtors have
11 statutory standing to exercise trustee avoiding powers.

12 In light of the *Cohen* decision, the DIR’s citation to cases from other jurisdictions carries little
13 weight. The panel’s holistic approach to analyzing this issue is reasonable and convincing. I conclude
14 that Wrighton has standing to bring this adversary proceeding.

15 16 **II. The State’s Lien Cannot Be Avoided Because It Is A Statutory Lien.**

17 Section 547(b) of the Bankruptcy Code allows the trustee to avoid preferential transfers. That
18 section, however is subject to several exceptions set forth in § 547(c). One of those exceptions prevents
19 avoidance of a statutory lien that is not avoidable under § 545 of the Code. 11 U.S.C. § 547(c)(6). No
20 one here disputes that the DIR perfected its lien before Wrighton filed his bankruptcy petition. As a
21 result, if the lien is a statutory lien, it cannot be avoided under § 545 and Wrighton’s § 547(b) claim
22 must fail.

23 Statutory liens arise “solely by force of a statute on specified circumstances or conditions.” 11
24 U.S.C. § 101(53). The pivotal feature is the lack of need for an agreement or judgment to create the
25 lien. 1 COLLIER ON BANKRUPTCY ¶101.53 (15th rev. ed. 2005). The lien must arise automatically upon
26 the circumstances specified in the statute. Judicial liens, by contrast, are obtained “by judgment, levy,
27 sequestration, or other legal or equitable process” *id.* at § 101(36), while consensual liens, i.e. security
28 interests, are created by agreement of the parties *id.* at § 101(51).

1 A lien is not necessarily a statutory lien because a statute authorizes or mentions the lien; the
2 Code's definition of a statutory lien specifically excludes security interests or judicial liens even if they
3 are provided by, dependent on, or made fully effective by a statute." *Id.* at § 101(53). When it is
4 evident from a statute that a judicial proceeding or other legal process is necessary before the lien arises,
5 the lien is judicial, not statutory. For example, a bankruptcy court in New Jersey characterized a lien
6 as judicial where, under the terms of the statute, the lien did not arise until after administrative
7 adjudication was complete and a statement containing the complete findings of fact, conclusions of law,
8 award and judgment establishing uninsured employer liability had been docketed with the court. *In re*
9 *Downey*, 261 B.R. 124, 126 (Bankr. D.N.J. 2001). Similarly, a Pennsylvania bankruptcy court found
10 a lien to be judicial where the statute offered it as a collection tool that arose only after administrative
11 adjudication of liability was completed. *In re Barbe*, 24 B.R. 739, 740 (Bankr. M.D. Pa. 1982). In *In*
12 *re Plumee*, 100 B. R. 304 (Bankr. D.S.C. 1989), the court characterized a lien securing attorneys' fees
13 as judicial because, under the statute, it only arose as to fees "awarded by the court," which made it
14 clear that a judicial proceeding was necessary. *Id.* at 306.

15 Nevertheless, some administrative action to identify and perfect a lien will not transform a
16 statutory lien into a judicial lien. *Graffen v. Philadelphia*, 984 F.2d 91, 96-97 (3d Cir. 1992). In
17 *Graffen*, a statute authorized the city of Philadelphia to determine the amount of unpaid water service
18 provided to property and to forward a lien in the amount of the unpaid charges for docketing against the
19 property served. The third circuit reasoned that the water department's administrative determination
20 of the amount of the lien did not amount to the type of legal process necessary for a judicial lien.
21 Rather, it was simply a specified circumstance or condition to the lien arising. *Id.* at 96. The court also
22 found that the mere act of docketing the lien to perfect it was no more than a statutory condition for
23 creating the lien. *Id.* Relying on its decision in *Graffen*, the third circuit recently concluded that a New
24 Jersey statute imposing surcharges for certain types of driving violations did not contemplate any
25 judicial process where it authorized the director of the New Jersey Department of Motor Vehicles to
26 issue a certificate for recording that identified the debtor and the amount of debt owed. *In re Schick*,
27 418 F.3d 312 (3d Cir. 2005). Accord, *In re Fennelly*, 212 B.R. 61, 64 (D.N.J. 1997)(interpreting same
28 statute as *Schick*). Further, a bankruptcy court in Arizona determined that a statute allowing a

1 condominium association to file a declaration to perfect a lien for unpaid condominium assessments was
2 statutory even though the amount of a lien could not be determined until a condominium association
3 “levied” an assessment and it went unpaid. The court reasoned that, like a financing statement, the
4 condominium association’s lien securing unpaid future assessments was perfected upon the filing of the
5 declaration; only the amount was determined later. *In re Reece*, 274 B.R. 515, 518-20 (Bankr. D. Ariz.
6 2001).

7 Based on the Code’s definitions of judicial and statutory liens and the case law interpreting the
8 distinctions between the two, I conclude that the DIR lien at issue herein qualifies as a statutory lien.
9 First, the genesis of the lien is statutory. It is found in § 3720 of the California Labor Code, which
10 authorizes the DIR to file a certificate of *lien* and provides that the lien will arise upon the recording of
11 the certificate. Second, § 3720 does not require any legal or judicial process to occur before the lien
12 arises. Although the director of the DIR can wait to issue a certificate of lien after the WCAB
13 determines that an employer is illegally uninsured, there is no requirement that the administrative
14 proceedings be fully adjudicated. Rather, the statute authorizes the director to record a certificate of lien
15 upon an assessment that the employer is *prima facie* illegally uninsured. As I have already noted, the
16 required basis for this finding is minimal. It simply does not rise to the level of “legal process”
17 contemplated in the Code’s definition of a judicial lien. Because § 3720 does not require the
18 adjudicatory process before the WCAB to be started, much less completed, before the certificate of lien
19 is recorded, liens filed under § 3720 arise solely on conditions specified in the statute and are not
20 dependent on any judicial or other legal process.

21 It makes no difference, as Wrighton argues, that § 3720 provides that the lien will have the same
22 “force, effect and priority as a judgment lien.” While this statutory provision may affect the lien’s
23 enforcement or priority vis à vis other liens, it has nothing to do with how the lien is created. Indeed,
24 the fact that the state legislature believed it necessary to liken the lien to a judicial lien suggests that it
25 is actually something other than a judicial lien.

26 I also find it persuasive that the purpose behind § 3720 liens is not unlike the purpose behind
27 other statutory liens. Statutory liens often are imposed to secure compensation for persons who will be
28 furnishing services or materials to another. Typical examples are mechanics’ liens, landlords’ liens and

1 attorneys' liens. To encourage the provision of services or materials, a statute will authorize a lien to
2 secure payment of amounts that may, in the future, go unpaid. In the same way, § 3720 allows the
3 administrator of the UEF to record a lien to secure reimbursement for amounts that the fund may, in the
4 future, have to pay to an injured worker if the uninsured employer fails to pay. It protects the welfare
5 of the state's workforce by ensuring the availability of workers' compensation benefits to all.

6 Finally, it is worth noting that the bankruptcy appellate panel for this circuit, on one occasion,
7 has characterized certificates of workers' compensation liens filed pursuant to § 3720 as a statutory
8 liens. *See In re DaRosa*, 318 B.R. 871 (9th Cir. B.A.P. 2004)(labeling two § 3720 certificates of lien as
9 the "Statutory Liens"). In *DaRosa* two debtors sought to avoid judicial liens against their residences
10 on exemption impairment grounds. The lienholder argued that, for purposes of calculating impairment,
11 each debtor was only entitled to include half of the value of the statutory liens because the debtors were
12 subrogated to each other with respect to the other half. While no one in *DaRosa* disputed whether the
13 § 3720 liens were statutory, it is significant that the appellate panel took care to describe how the statute
14 operated before assigning the label of "statutory lien" to the certificate of liens. *Id.* at 874, *quoting*, 65
15 CAL. JUR. 3d, Work Injury Compensation § 708 (2004).

16 17 CONCLUSION

18 For the reasons explained, Wrighton has standing to pursue this avoidance action. However, the
19 lien he seeks to avoid is a statutory lien that is not subject to avoidance under § 545 of the Bankruptcy
20 Code. Because the recording of the statutory lien is an exception to Wrighton's avoidance powers, the
21 avoidance claim fails to state a claim upon which relief can be granted. The defendant's motion to
22 dismiss plaintiff's complaint is granted.

23
24 Good cause appearing, IT IS SO ORDERED.

25
26 ***** END OF ORDER *****
27
28

Adv. P. 05-5439

UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA
SERVICE LIST

James M. Lauderdale
Lauderdale Law Offices
150 Carmelito Avenue
Monterey, CA 93940

Vanessa L. Holton
A. Roger Jeanson
Gayle T. Oshima
State of California
Department of Industrial Relations
Office of the Director - Legal Unit
455 Golden Gate Avenue, Suite 9516
San Francisco, CA 94102